MEMORANDUM — HOUSE FISCAL AGENCY

DATE: March 2, 2011

TO: House Tax Policy Committee

FROM: Rebecca Ross, Senior Economist
Jim Stansell, Economist

RE: FY 2011-12 Executive Recommendation for Tax Changes

This memorandum describes the Executive Recommendation for tax changes. These tax changes consist of eliminating the Michigan Business Tax (MBT), imposing a new corporate income tax, and eliminating various income tax expenditures – primarily the pension exemption and the earned income tax credit (EITC). In total, these tax changes would reduce revenue by an estimated $254.1 million in FY 2011-12 and increase revenue by $32.1 million in FY 2012-13. These tax changes would increase General Fund/General Purpose (GF/GP) revenue by an estimated $339.8 million in FY 2011-12 and $558.7 million in FY 2012-13; it would also reduce School Aid Fund (SAF) revenue by an estimated $593.9 million in FY 2011-12 and $526.6 million in FY 2012-13. Table 1 includes the estimated fiscal impact of the Executive Recommendation for tax changes, which would be effective January 1, 2012. The details of the plan are described below.

Table 1
Potential Tax Changes Under the Executive Recommendation
Effective Date January 1, 2012
(Millions of Dollars)

Business Tax Related	**FY 2011-12 Estimates**	**FY 2012-13 Estimates**
Repeal MBT	($2,170.0)	($2,024.4)
Partial Year MBT	900.2	0.0
6% Corporate Income Tax (Only C Corps)	460.1	748.8
Financial Institutions Tax	27.7	43.9
Honor Existing Firm-Specific Credits	(293.0)	(500.0)
Net Business Tax Change	**(1,075.0)**	**(1,731.7)**
Income Tax Related		
Individual Income Tax Changes	820.9	1,863.8
Reserved for Future Tax Cuts	0.0	(100.0)
Net Income Tax Change	**820.9**	**1,763.8**
Total Tax Changes	**(254.1)**	**32.1**
GF/GP	339.8	558.7
SAF	(593.9)	(526.6)

MBT and Corporate Income Tax Changes

Combined, the MBT and corporate income tax changes proposed in the Executive Recommendation would reduce business taxes by an estimated $1.08 billion in FY 2011-12 and $1.73 billion, which is an 86% reduction on a full year basis in FY 2012-13.

Battery Credits. A variety of credits are issued for battery related activity: pack engineering, integration and assembly credits, vehicle engineering credit, advanced battery technologies credit, and battery cell manufacturing credits.

Other Credits. Historic, farmland, and workers disability credits. The historic preservation credit provides a credit up to 25% of expenditures for the restoration of a qualified historic site. The farmland preservation credit provides property tax relief for corporate farms. The workers' disability supplemental benefit credit provides for 100% of the supplemental cost of living payments made to persons injured between September 1965 and December 1979.

Income Tax Changes

The income tax changes proposed by the Governor would increase the income tax by an estimated $820.9 million in FY 2011-12 and $1.86 billion in FY 2012-13. The proposed changes are as follows.

Freeze income tax rate at 4.25%. Under current law, the income tax rate is 4.35%. Beginning October 1, 2011 the rate will be reduced by 0.1 percentage points each year until the rate reaches 3.95%; then the rate will be reduced to 3.9% effective October 1, 2015.

Eliminate pension exemption. Under current law, social security, military, federal, state and local government pension/retirement income is fully exempt. Private pensions are exempt up to $45,120 single/$90,240 joint (TY 2010) – these levels are indexed to inflation. In Michigan, defined benefit plans, IRAs, and annuities are fully exempt. Also, 401(k) distributions attributable to employer contributions or to employee contributions that are matched by the employer are exempt, but distributions attributable to employee contributions that are not matched by the employer are currently subject to the State income tax, subject to the private pension limits. In addition, 401(k)s with no employer match are not considered pensions and therefore are completely subject to the income tax. The Executive Recommendation would eliminate these exemptions (except for social security).

Eliminate the dividends, interest, capital gains exemption received by seniors. Under current law, senior investment income up to $10,058 single/$20,115 joint (TY 2010, indexed to inflation) is exempt.

Eliminate the $2,300 (TY 2010, indexed to inflation) special exemptions for seniors and individuals with unemployment compensation equal to or greater than 50% of their AGI (adjusted gross income, Michigan's starting point from federal return).

Personal exemption phase-out. Under current law, $3,700 (TY 2011, indexed to inflation) is exempt from AGI for each personal exemption claimed on the federal income tax return. The personal exemption increases in $100 increments based on inflation. The Executive Recommendation would phase-out the personal exemption for single taxpayers between the income range of $75,000 and $100,000 and for married taxpayers between the income range of $150,000 and $200,000. Taxpayers with incomes above the upper bound would receive no personal exemption.

Eliminate child deduction. The child deduction provides a $600 subtraction from AGI for each dependent child age 18 or younger.

Eliminate miscellaneous subtractions. The Executive Recommendation would eliminate political contributions; prizes won from bingo, raffle, or charity games; losses from the disposal of property; income from gas and oil royalty interest; certain distributions from IRAs used to pay higher education

Eliminate the adoption credit. The adoption credit provides refundable credit of up to $1,200 to the extent that qualified adoption expenses exceed the amount allowed under the federal adoption credit.

Eliminate the stillbirth credit. This refundable credit is available to taxpayers who have been provided with a Certificate of Stillbirth. The credit is equal to 4.5% of the personal exemption amount, rounded to the closest $10 increment.

Eliminate EITC. The EITC is a refundable credit for working low income households equal to 20% of the federal EITC. This would increase revenue by an estimated $340 million for FY 2012-13. In recent years, a portion of the state earned income tax credit has been used to meet maintenance of effort (MOE) requirements for federal Temporary Assistance for Needy Families (TANF) dollars. Elimination of the credit would also eliminate this TANF MOE claim generated by the State EITC. Thus, other eligible state spending would need to be identified to ensure that MOE requirements were met.

Homestead property tax credit (HPTC) changes. For TY 2008, Michigan taxpayers with household income less than $82,650 may claim a property tax credit, and the computed credit is reduced by 10% for every $1,000 that household income exceeds $73,650. Under current law, the credit is equal to 60% of the amount by which property taxes (or 20% of rent for renters) exceed 3.5% of household income, up to a maximum of $1,200. For seniors and disabled filers, the credit is equal to 100% of the difference. The proposed changes would adjust the percentage by which property taxes exceed 3.5% of household income to 80% for all filers except disabled taxpayers, who remain at 100%. In addition, the credit will begin to phase-out at an income level of $60,000.

Eliminate all designated voluntary contributions. Contributions to these funds increase taxpayers' liability or reduce their refund. Although eliminating these contribution options via the income tax could reduce total contributions for these funds, this change has no State fiscal impact.

Reserve $100 million for future tax cuts. The Executive Recommendation would also set aside $100 million from the income tax to be used for future tax cuts.

We hope this information is helpful. For additional updates, please consult our website at www.house.mi.gov/hfa. Contact us at (517) 373-8080 if you have any further questions.